

Banking, Insurance, Life Insurance and Health Insurance (prudential standards) determinations Nos. 1 and 2 of 2019

Insurance (prudential standard) determinations Nos. 1 to 9 of 2019

Life Insurance (prudential standard) determination No. 1 of 2019

Health Insurance (prudential standard) determination No. 1 of 2019

REPLACEMENT EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Banking Act 1959, section 11AF

Insurance Act 1973, section 32

Life Insurance Act 1995, section 230A

Private Health Insurance (Prudential Supervision) Act 2015, section 92

APRA may, in writing, determine, vary or revoke a prudential standard that applies to an APRA-regulated institution under:

- (1) subsections 11AF(1) and (3) of the *Banking Act 1959* (Banking Act), in relation to authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (authorised banking NOHCs);
- (2) subsections 32(1) and (4) of the *Insurance Act 1973* (Insurance Act), in relation to general insurers, authorised non-operating holding companies (authorised insurance NOHCs), and subsidiaries of general insurers and authorised insurance NOHCs;
- (3) subsections 230A(1) and (5) of the *Life Insurance Act 1995* (Life Insurance Act), in relation to life companies, friendly societies, registered non-operating holding companies (registered life NOHCs), and subsidiaries of life companies and registered life NOHCs; and
- (4) subsections 92(1) and (5) of the *Private Health Insurance (Prudential Supervision) Act 2015* (PHIPS Act), in relation to registered private health insurers.

On 17 April 2019, APRA made the following determinations (the Instruments):

- Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2019, which revokes *Prudential Standard CPS 220 Risk Management* (CPS 220) made under Banking, Insurance, Life Insurance and Health Insurance determination No. 1 of 2017, and determines a new *Prudential Standard CPS 220 Risk Management* (CPS 220);
- Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 2 of 2019, which revokes *Prudential Standard CPS 510*

Governance (CPS 510) made under Banking, Insurance, Life Insurance and Health Insurance determination No. 1 of 2018, and determines a new *Prudential Standard CPS 510 Governance* (CPS 510);

- Insurance (prudential standard) determination No. 1 of 2019 which revokes *Prudential Standard GPS 110 Capital Adequacy* (GPS 110) made under Insurance determination No. 3 of 2014 and determines a new *Prudential Standard GPS 110 Capital Adequacy* (GPS 110);
- Insurance (prudential standard) determination No. 2 of 2019 which revokes *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital* (GPS 112) made under Insurance determination No. 15 of 2012 and determines a new *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital* (GPS 112);
- Insurance (prudential standard) determination No. 3 of 2019 which revokes *Prudential Standard GPS 113 Capital Adequacy: Internal Model-based Method* (GPS 113) made under Insurance determination No. 4 of 2014 and determines a new *Prudential Standard GPS 113 Capital Adequacy: Internal Model-based Method* (GPS 113);
- Insurance (prudential standard) determination No. 4 of 2019 which revokes *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge* (GPS 114) made under Insurance determination No. 1 of 2017 and determines a new *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge* (GPS 114);
- Insurance (prudential standard) determination No. 5 of 2019 which revokes *Prudential Standard GPS 115 Capital Adequacy: Insurance Risk Charge* (GPS 115) made under Insurance determination No. 5 of 2012 and determines a new *Prudential Standard GPS 115 Capital Adequacy: Insurance Risk Charge* (GPS 115);
- Insurance (prudential standard) determination No. 6 of 2019 which revokes *Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge* (GPS 116) made under Insurance determination No. 6 of 2012 and determines a new *Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge* (GPS 116);
- Insurance (prudential standard) determination No. 7 of 2019 which revokes *Prudential Standard GPS 118 Capital Adequacy: Operational Risk Charge* (GPS 118) made under Insurance determination No. 8 of 2012 and determines a new *Prudential Standard GPS 118 Capital Adequacy: Operational Risk Charge* (GPS 118);
- Insurance (prudential standard) determination No. 8 of 2019 which revokes *Prudential Standard GPS 120 Assets in Australia* (GPS 120) made under Insurance determination No. 9 of 2012 and determines a new *Prudential Standard GPS 120 Assets in Australia* (GPS 120);
- Insurance (prudential standard) determination No. 9 of 2019 which revokes *Prudential Standard GPS 310 Audit and Related Matters* (GPS 310) made

under Insurance determination No. 5 of 2014 and determines a new *Prudential Standard GPS 310 Audit and Related Matters* (GPS 310);

- Health Insurance (prudential standard) determination No. 1 of 2019 which revokes *Prudential Standard HPS 310 Audit and Related Matters* (HPS 310) made under Health Insurance (prudential standard) determination No. 1 of 2018 and determines a new *Prudential Standard HPS 310 Audit and Related Matters* (HPS 310); and
- Life Insurance (prudential standard) determination No. 1 of 2019 which revokes *Prudential Standard LPS 700 Friendly Society Benefit Funds* (LPS 700) made under Insurance determination No. 16 of 2012 and determines a new *Prudential Standard LPS 700 Friendly Society Benefit Funds* (LPS 700). These instruments commence on 1 July 2019.

1. Background

On 31 May 2018, APRA made Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2018 which, effective 1 July 2019, revokes three actuarial prudential standards applying to general insurers, life insurers and private health insurers (*Prudential Standard GPS 320 Actuarial and Related Matters* (GPS 320), *Prudential Standard LPS 320 Actuarial and Related Matters* (LPS 320) and *Prudential Standard HPS 320 Actuarial and Related Matters* (HPS 320)) and determines *Prudential Standard CPS 320 Actuarial and Related Matters* (CPS 320); a cross-industry prudential standard containing the consolidated actuarial requirements from GPS 320, LPS 320 and HPS 320.

For consistency between the industries, the valuation requirements specific to general insurance have been moved to a new *Prudential Standard GPS 340 Insurance Liability Valuation* (GPS 340) which also commences on 1 July 2019.

The introduction of CPS 320 requires consequential amendments to twelve APRA prudential standards. These include two standards applying across APRA-regulated institutions in the banking, general insurance, life insurance and private health insurance industries, nine standards applicable to general insurers and one standard applicable to life insurers. As part of this process, APRA has taken the opportunity to make other practical minor and machinery updates, including a correction to one standard applicable to private health insurers.

The Instruments:

- replace references to the revoked GPS 320, LPS 320 and HPS 320 with references to the new CPS 320 and GPS 340;
- update references from the Insurance Liability Valuation Report to the Actuarial Valuation Report;
- streamline clauses regarding reliance on previous exercises of discretion by APRA;
- delete superseded transitional provisions;
- update legislative references; and
- correct typographical errors.

For general insurers, three minor changes to GPS 116 are proposed to reflect current definitions and practice and to continue the requirement for Group Actuaries to provide the Board of a Level 2 insurance group with an opinion on the Insurance Concentration Risk Charge.

2. Purpose and operation of the instruments

The purpose of the Instruments is to revoke the thirteen existing prudential standards requiring consequential or minor and machinery amendments and replace them with corresponding standards which incorporate appropriate amendments.

The prudential standards which have been revoked and replaced are:

- *Prudential Standard CPS 220 Risk Management*, which requires an APRA-regulated institution and a Head of a group to have systems for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks that may affect its ability, or the ability of the group it heads, to meet its obligations to depositors and/or policyholders;
- *Prudential Standard CPS 510 Governance*, which sets out minimum foundations for good governance of an APRA-regulated institution in the deposit-taking, general insurance, life insurance and private health insurance industries, and of a Head of a group;
- *Prudential Standard GPS 110 Capital Adequacy*, which requires a general insurer or Level 2 insurance group to maintain adequate capital against the risks associated with its activities;
- *Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital*, which sets out the characteristics that an instrument must have to qualify for inclusion in the capital base of a general insurer or Level 2 insurance group and the various regulatory adjustments to be made to determine the capital base;
- *Prudential Standard GPS 113 Capital Adequacy: Internal Model-based Method*, which sets out the requirements that a general insurer or Level 2 insurance group must meet to use an Internal Model-based Method for calculating the prescribed capital amount of the general insurer or Level 2 insurance group, both at the time of application and subsequently;
- *Prudential Standard GPS 114 Capital Adequacy: Asset Risk Charge*, which requires a general insurer or Level 2 insurance group to maintain adequate capital against the asset risks associated with its activities;
- *Prudential Standard GPS 115 Capital Adequacy: Insurance Risk Charge*, which requires a general insurer or Level 2 insurance group to maintain adequate capital against the insurance risks associated with its activities;
- *Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge*, which requires a general insurer or Level 2 insurance group to maintain adequate capital against the risks associated with insurance concentration in its activities;
- *Prudential Standard GPS 118 Capital Adequacy: Operational Risk Charge*, which requires a general insurer or Level 2 insurance group to maintain adequate capital against the operational risks associated with its activities;
- *Prudential Standard GPS 120 Assets in Australia*, which specifies certain assets that are excluded from being treated as ‘assets in Australia’ by a general insurer for the purposes of section 28 of the Insurance Act;

- *Prudential Standard GPS 310 Audit and Related Matters*, which sets out the roles and responsibilities of a general insurer's and Level 2 insurance group's Appointed Auditor and Group Auditor, and the obligations of a general insurer or Level 2 insurance group to make arrangements to enable its Auditor to fulfil their responsibilities;
- *Prudential Standard HPS 310 Audit and Related Matters*, which establishes requirements for the provision, to the Board and senior management of a private health insurer, of independent advice in relation to the operations, financial position and risk controls of the business operations of the private health insurer; and
- *Prudential Standard LPS 700 Friendly Society Benefit Funds*, which sets out the requirements for the establishment, structure and operation of an approved benefit fund of a friendly society so that it is fair and equitable for its members.

The consequential and minor and machinery amendments which have been made to each of the thirteen existing prudential standards are as follows:

- The new CPS 220 made under Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 1 of 2019 replaces references to the revoked GPS 320, LPS 320 and HPS 320 with a reference to the new CPS 320, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and corrects a typographical error;
- The new CPS 510 made under Banking, Insurance, Life Insurance and Health Insurance (prudential standard) determination No. 2 of 2019 replaces a reference to GPS 320 to CPS 320, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and corrects a typographical error;
- The new GPS 110 made under Insurance (prudential standard) determination No. 1 of 2019 replaces references to the revoked GPS 320 with references to the new CPS 320 or GPS 340 as appropriate, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and includes an updated reference to run-off provisions in CPS 320;
- The new GPS 112 made under Insurance (prudential standard) determination No. 2 of 2019 replaces references to the revoked GPS 320 with references to the new GPS 340, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and deletes transitional paragraphs in the revoked GPS 112;
- The new GPS 113 made under Insurance (prudential standard) determination No. 3 of 2019 replaces a reference to the revoked GPS 320 with a reference to the new CPS 320, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and replaces a reference to Insurance Liability Valuation Report (ILVR) to Actuarial Valuation Report (AVR);
- The new GPS 114 made under Insurance (prudential standard) determination No. 4 of 2019 replaces references to the revoked GPS 320 with references to the

new GPS 340, and includes minor amendments to the clause dealing with determinations made under previous prudential standards;

- The new GPS 115 made under Insurance (prudential standard) determination No. 5 of 2019 replaces references to the revoked GPS 320 with references to the new GPS 340, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and replaces a reference to Insurance Liability Valuation Report (ILVR) to Actuarial Valuation Report (AVR);
- The new GPS 116 made under Insurance (prudential standard) determination No. 6 of 2019 replaces references to the revoked GPS 320 with references to the new GPS 320 or GPS 340 as appropriate, deletes transitional paragraphs in the revoked GPS 116, replaces references to Insurance Liability Valuation Report (ILVR) to Actuarial Valuation Report (AVR), includes minor amendments to the clause dealing with determinations made under previous prudential standards, and includes other minor amendments to update definitions, clarify reporting periods and preserve reporting requirements for Group Actuaries of a Level 2 insurance group;
- The new GPS 118 made under Insurance (prudential standard) determination No. 7 of 2019 replaces a reference to the revoked GPS 320 with a reference to the new GPS 340 and deletes a transitional paragraph in the revoked GPS 118;
- The new GPS 120 made under Insurance (prudential standard) determination No. 8 of 2019 replaces references to the revoked GPS 320 with references to the new GPS 340, includes minor amendments to the clause dealing with determinations made under previous prudential standards, and corrects a typographical error;
- The new GPS 310 made under Insurance (prudential standard) determination No. 9 of 2019 replaces a reference to the revoked GPS 320 with a reference to the new GPS 340, and updates a reference to a legislative provision;
- The new HPS 310 made under Health Insurance (prudential standard) determination No. 1 of 2019 updates a reference to ‘reasonable assurance’ in the revoked HPS 310 to ‘limited assurance’; and
- The new LPS 700 made under Life Insurance (prudential standard) determination No. 1 of 2019 replaces references to the revoked LPS 320 to CPS 320.

Where these standards refer to an Act, Regulation or Prudential Standard, this is a reference to the document as it exists from time to time, and which is available on the Federal Register of Legislation at www.legislation.gov.au.

Merits review

The prudential standards provide for APRA to exercise various discretions. Decisions made by the APRA exercising those discretions are not subject to merits review. This

is because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

A breach of a prudential standard is also a breach of the enabling legislation, as each enabling Act provides that regulated entities must comply with the standard. However there are no penalties prescribed for such breaches. Instead, an entity's breach of the prudential standard/enabling legislation is grounds for the APRA to make further, substantive decisions under the enabling legislation in relation to the entity. Those decisions are:

- (a) to issue a direction to:
 - (i) to comply with the whole or part of a prudential standard (s.11CA Banking Act);
 - (ii) to comply with the whole or part of a prudential standard (s.104 Insurance Act);
 - (iii) to comply with the whole or part of a prudential standard (s.230B Life Insurance Act); and
 - (iv) to comply with all, or specified, enforceable obligations, which includes prudential standards (s.96 PHIPS Act).
- (b) to revoke:
 - (i) an authorisation to carry on banking business (s.9A Banking Act);
 - (ii) a NOHC authorisation (s.11AB Banking Act);
 - (iii) an authorisation to carry on insurance business (s.15 Insurance Act);
 - (iv) a NOHC authorisation (s.21 Insurance Act);
 - (v) registration under the Life Insurance Act (s.26 Life Insurance Act);
 - (vi) a NOHC authorisation (s.28C Life Insurance Act)

It is only at this stage that an entity is exposed to a penalty. Failure to comply with a direction is an offence punishable by:

- (a) 50 penalty units (s.11CG Banking Act);
- (b) 50 penalty units (s.108 Insurance Act);
- (c) 50 penalty units (s.230F Life Insurance Act);
- (d) 30 penalty units (s.104 PHIPS Act).

The decisions of APRA to impose a direction are subject to merits review (s.11CA Banking Act, s.104 Insurance Act, s.236 Life Insurance Act, s.168 PHIPS Act), which is appropriately available at the point where an entity could be exposed to a penalty.

All decisions to revoke authorisations/registrations under the Banking Act, Insurance Act and Life Insurance Act are subject to merits review, unless specifically excluded by the enabling legislation.

Revocation of an authorisation to carry on banking business or as a NOHC of an ADI is subject to merits review unless either:

- (a) APRA has determined that access to natural justice and merits review is contrary to the national interest or contrary to the interests of depositors with the body corporate; or
- (b) (in the case of ADIs only) the authority is an authority that is to cease to have effect on a day specified in the authority (s.9A(8)).

Revocation of an authorisation to carry on insurance business or as a NOHC of an authorised insurer is subject to merits review (ss. 15 and 21 Insurance Act).

Revocation of registration as a life insurance company or as a NOHC of a life insurance company is subject to merits review (s. 236 Life Insurance Act).

The situation in relation to cancellation of registration under the PHIPS Act is different to the other enabling legislation. A compulsory cancellation of registration can only occur after a terminating manager has been appointed by the Federal Court under s.66 of the PHIPS Act on application of an external manager appointed under section 51 of the PHIPS Act. An external manager may be appointed on the basis of a breach of a prudential standard, but only of a prudential standard relating to capital adequacy or solvency that applies in relation to the fund (s.52 PHIPS). The prudential standards that are made by the Instruments, either wholly (HPS 310) or partly (CPS 220 and CPS 510), do not relate to capital adequacy or solvency. Even if they did, the requirement under section 66 to apply to the Federal Court for termination of registration effectively provides appropriate independent review of a decision based on a breach of a prudential standard relating to capital adequacy or solvency.

In addition to the differences regarding termination of registration, breach of a prudential standard permits APRA to apply to the Federal Court for a declaration of contravention under s.154 of the PHIPS Act. This may lead to a civil penalty order under s.156, a compensation order under s.157 or any other order that APRA applies for under s.158 of the PHIPS Act. As with the process for compulsory cancellation of registration, the fact that these steps require Federal Court scrutiny provides an appropriate level of independent review.

3. Consultation

APRA undertook consultations on its proposed *Prudential Standard CPS 320 Actuarial and Related Matters* as part of its broader consultation on *the role of the Appointed Actuary and actuarial advice within insurers*.

The consequential amendments which the Instruments give effect to were foreshadowed as part of this consultation. As the changes are minor and machinery, APRA did not undertake consultation on the specific proposed amendments.

4. Regulation Impact Statement

A Regulation Impact Statement is not required for the machinery and minor changes described in this explanatory statement.

5. Statement of compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

A Statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.

ATTACHMENT A

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

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These Legislative Instruments are compatible with the human rights and freedoms recognised or declared in the international instrument listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instruments

The purpose of these instruments is to make consequential changes to prudential standards to reflect the introduction of CPS 320 and GPS 340 and to make other practical minor and machinery updates. The Instruments update references to the new prudential standards and change references from the Insurance Liability Valuation Report to the Actuarial Valuation Report. The Instruments also streamline clauses regarding exercises of discretion by APRA under previous prudential standards, delete outdated transitional provisions and correct typographical errors. Three minor practical changes have also been made to *Prudential Standard GPS 116 Capital Adequacy: Insurance Concentration Risk Charge* to update definitions, clarify reporting periods and preserve reporting requirements for Group Actuaries of a Level 2 insurance group. The amendments effected by the Instruments form part of a broader review of the actuarial prudential framework designed to ensure CPS 320 and GPS 340 remain fit for purpose.

Human rights implications

APRA has assessed the instruments against the international instruments listed in section 3 of the HRPS Act and has determined that the instruments do not engage any of the applicable rights or freedoms.

Conclusion

These Legislative Instruments are compatible with human rights as they do not raise any human rights issues.